THE ECONOMIC SITUATION

A Strom Thurmond Institute and
College of Business & Public Affairs Report

Bruce Yandle

VOLUME VII, NO. 1 A quarterly report on economic trends. **WINTER 1999**

- Is the economy down but not out?
- What about the year ahead? Will 1999 be better or worse?
- South Carolina's strong economy. Will it continue?
- Lifting all the boats. What has happened to the welfare rolls?

Is The Economy the Real Come-Back Kid?

Over the last few years, advisers to national political candidates have emphasized that "It's the economy, stupid." A simple prescription seems to follow. If people are worried about job security and paying bills, then they want to hear about actions that can be taken to make things better. If everything is rosy, then let's hear some talk about cutting taxes and making things even better.

But what about this economy? Is it unsinkable?

Asia falls apart. Russia defaults. And that great synthesizer of financial information, the stock market, has recently looked more like the Great Scream Machine than the Great Bread Machine it represents. The troublesome news goes on, including the possible impeachment of a sitting president. Yet so does the economy.

We all heard the post-August analysts, serious and grave, explaining how the financial markets really were over-priced, just as they had suggested, that it might be years before the Dow-Jones recovered. Then, we were reminded by talk-show panelists far and wide that a serious deflationary spiral was underway, one that might pull our great bread machines to pieces. Well it isn't over yet, but things economic surely feel better now than they did in August and September. What changed, other than the animal spirits that might explain part of our market behavior? Is the economy the true come-back kid?

After the series of shocks that took the steam out of the stock market, hard evidence began to arrive telling us that ordinary Americans were still betting on the economy. They were not cashing out of the market in droves. Then, we received data on new home sales and housing starts. The best showing in years. As the fall progressed, reports of record auto sales arrived. Then, third quarter real GDP growth was announced, with the hot 3.3% number putting second quarter's 1.6% growth rate to shame.

Through it all, Mr. Greenspan performed admirably, tweaking interest rates ever so carefully to let us know he was on our side. Buried deeply in arcane Fed reports was news that the nation's money supply growth was rising like Old Faithful. In a word, the Fed has become very "accommodating." Every cloud has a silver lining, and those of the late-summer storm clouds look pretty good.

But there's more data to consider. In the midst of

Sponsored by the BB&T Scholar's Program at Clemson University

positive news on housing starts, auto sales, GDP growth, and lower interest rates, we have also learned that manufacturing activity continues to slump, that job growth is falling, and manufacturing layoffs are expanding. We also heard that some major retailers are cutting their sales forecasts. Other negative news told us that consumer confidence was weakening, and that once again, major financial institutions would be making major cutbacks. Yes, every silver lining has its cloud, and these look pretty troublesome.

What About 1999?

What can we make of this mixed bag of economic data? Is this the pause that refreshes or the beginning of an extended economic slowdown?

Even though the never-say-die economy has so far proved them wrong, forecasters are sticking to their promised slowdown. And as the lawyers might say, the preponderance of evidence is on the forecasters' side. Just how much of a slowdown are we talking about? And when?

We are not talking about a recession, an absolute decline in GDP growth. The latest word from the WEFA forecasting group sees things this way: Real GDP growth for 1998 should come in at 3.4%. Then, starting in 4Q1998, we start slipping down the side of the saucer with GDP growth registering 2.4% for 1999. (By the way, this is the same growth predicted by the Wake Forest forecasting unit.) Having run across the saucer's bottom, the economy enters a stronger year 2000, according to WEFA, with GDP growth hitting 3.9%. The consensus Blue Chip forecast follows a similar pattern, with 3.4% growth for 1998 and 2.1% for 1999. Things pick up for them too in 2000.

Well, talk of numbers and saucers can be interesting, but what's the logic behind the numbers. What's going on here?

By and large, there is one explanation: the Asian slowdown and recovery pattern. Most of the Asian economies now in the tank are expected to move to positive ground by the time the year 2000 rolls around. For example, when the Blue Chip forecasters look around the globe and call out numbers for 1999, they see Japan, South Korea, Hong Kong, and Singapore, to name a few, registering positive GDP again, with things getting even better in 2000. China's economy is expected to show 1999 growth in excess of 6.0%. On top of this good news, Europe is predicted to do better than the U.S. next year.

While U.S. exports have been pretty well sent to the cellar this year, those shipments will build back across the next two years. With domestic activity holding its own, the added export stimulus will push us to higher ground.

How Does South Carolina Fit into the Picture?

Throughout this time of Asian tremors, South Carolina has done far better than merely rolling with the punches. The state economy has shown a remarkable immunity to the whole thing. Of course, there are sectors and industries where this is clearly not the case, but the state's overall performance has been stronger than that of the nation or the region.

With things slowing down and then getting better for the nation, will South Carolina continue its stellar performance? Sorry, folks, it's not in the cards, at least in the opinion of major forecasting groups.

Here's the picture for growth in state total personal income. According to WEFA, the 1998 number looks like 6.8%, as compared to 6.1% in 1997. 1999 should show a 4.6% growth rate, which is substantially lower than this year's. Then, with things looking up in 2000, the forecasters call for a 5.3% growth rate. Another saucer-shaped economy.

And what's the major driver? Answer: Growth in manufacturing employment, which has hardly been cause for celebration, is expected to weaken considerably over the next two years. With weakness in the cards, we may take some comfort in the knowledge that our state will be second to North Carolina in predicted income growth for the region, doing better than Georgia for the first time in several years.

The construction and services sectors have been strong economic engines in the state for some time now, with construction taking the prize for sheer brute strength. These two sectors will continue to show combined strength over the next two years. For example, housing starts are expected to remain solid, but not as good as in 1998. Retailing, which seems to march to the beat of a different drum, is expected to remain strong as well. In fact, new car sales in 1999 are expected to maintain their 1998 pace.

Of course, purchases of big-ticket items, like autos and home furnishings, seem to be powered by employment and to some extent, interest rates. With relatively strong labor markets continuing in 1999 and 2000, and with interest rates remaining close to current levels, retailing should continue apace.

The South Carolina bread machine seems to be in reasonably good shape.

The Diminishing State Welfare Rolls

South Carolina's strong economy has undoubtedly provided brighter opportunities for the work-age population and in doing so made things better for families. After all, with unemployment rates falling below 3% in some counties and averaging in the low fours overall, economic opportunity has been strong. With everything else the same, we should expect the number of welfare recipients to decline in times like these. And they have. In fact, on a June 1998/1997 basis, the number of S.C. welfare cases has fallen 38%. But there is more to story than a strong economy.

Welfare reform in Washington returned to the states primary responsibility for managing the social safety net. Along with a return to the states came a new emphasis on work, parental responsibility, and limits on total dollar amounts to be received. Business firms now receive tax incentives for employing former welfare recipients. Also the incentive for couples to split so that a child and mother might quality for welfare has been weakened. At least two forces are affecting the welfare rolls. A strong economy and welfare reform. And we cannot really know which is the stronger of the two.

Fortunately, for now, the economic outlook is bright enough to suggest that more people will be working and earning in the years ahead rather than falling into the welfare safety net. But as the economy travels the saucer bottom, we may learn more about the real effects of welfare reform.

Final Thoughts

There's a popular saying among economic forecasting that helps keep us humble. "If you can't forecast well, you must forecast often." Frequency is one thing. Timing is something else.

Fortunately, this newsletter is being written after the stock market's "adjustment" and post-October "recovery." Had I been writing immediately after the market collapse, it would have been difficult for me to maintain that "irrational passion for dispassionate rationality" claimed by economists. My concern about the economy then was related to strong deflationary forces playing through the world's economy. Major default on debt, like Russia's, wipes out credit and money. Asia's financial contractions do the same. And Brazil's so far avoided difficulties added another dark note to a picture of sharp contractions of credit and money, a falling price level worldwide, and repricing of assets. Since August, of course, major infusions of credit and money appear to have significantly blunted the edge of these deflationary threats. For now, we seem to have regained our economic footing. The U.S. economy did its part.

Once again, the world relies on the great American bread machine to pull it through troubled times. Free people working in free markets can do wonders.

Pass the word.

THE ECONOMIC SITUATION
The Strom Thurmond Institute
Clemson University
PO Box 345203
Clemson, SC 29634-5203

Non-profit Organization U.S. Postage PAID Permit No. 10 Clemson, S.C.

The Economic Situation is printed quarterly by the Strom Thurmond Institute of Government and Public Affairs at Clemson University and the College of Business and Public Affairs.   For more information contact the Strom Thurmond Institute at:

Telephone—(864)656-0215;
FAX— (864)656-4780;
e-mail—**publications@strom.clemson.edu**

Bruce Yandle is a Senior Fellow in the Strom Thurmond Institute of Government and Public Affairs at Clemson University. He is also an Alumni Professor and BB&T Scholar at Clemson University.

CLEMSON® UNIVERSITY

Printed on recycled paper.